Don’t give away equity

One of the first pieces of advice I offer my clients is to resist giving away equity in their company. Oftentimes, however, clients have already granted or promised shares of stock in their corporation (or membership interests in their LLC) to an early benefactor who provided something of value to the company, an employee who helped build early iterations of the company’s product or service, a business adviser or member of the board of directors.

A large percentage of these startups, early-stage and even growing midstage companies, believe that equity is a cheap and easy alternative to the cash they often lack. However, using equity in this way can be a grave mistake if not done carefully. Unfortunately, founders often fail to pay particular attention to an individual’s personality and consider the consequences of having that person in their enterprise as a shareholder with associated rights. Without attaching specific rights and restrictions to equity grants, it is nearly impossible to claw that equity back once it has been issued. Consequently, the company can only hope that without the express right to remove them as a shareholder, it has not bound itself to someone who causes more harm than good.

HBO’s Emmy-nominated comedy series Silicon Valley provides an excellent visual context for the potential pitfalls of indiscriminately giving away pieces of your company.

One character, Erlich Bachman, stands out as the singular embodiment of why it is important to know a person’s character, strengths and weaknesses before giving him or her equity. Erlich’s character flaws and shortcomings, and the aftermath of his actions provide a comical, yet not entirely exaggerated, pictorial of the consequences of compensating individuals with equity.

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